

1  
2  
3  
4  
5  
6  
7 BEFORE THE INSURANCE COMMISSIONER  
8 OF THE STATE OF WASHINGTON

9  
10 In the Matter of the Application  
11 regarding the Conversion and  
12 Acquisition of Control of Premera Blue  
13 Cross and its Affiliates.

No. G 02-45

FINDINGS OF FACT &  
CONCLUSIONS OF LAW  
(PROPOSED)

14  
15 **FINDINGS OF FACT**

16 **Procedural History and Premera's Form A Statement**

- 17 1. This matter came before the Insurance Commissioner of the State of Washington  
18 ("Commissioner") on the application of PREMERA and Premera Blue Cross  
19 (collectively, with affiliated entities, "Premera"), filed with the Office of the  
20 Washington Insurance Commissioner ("OIC"), which seeks the Commissioner's  
21 approval for the reorganization of PREMERA, Premera Blue Cross, and their  
22 nonprofit affiliates from nonprofit to for-profit companies.  
23 2. On May 30, 2002, Premera advised the OIC of its intent to reorganize Premera  
24 Blue Cross and certain of its affiliates from Washington nonprofit corporations to  
25 for-profit corporations, known as the "Conversion" or "proposed Conversion."  
Ex. S-71 (letter to Commissioner from G. Barlow and Y. Milo).  
3. On September 17, 2002, Premera filed a "Statement Regarding the Acquisition of  
Control of a Domestic Health Carrier and Domestic Insurer" ("Form A  
Statement"), the formal application required for approval of the reorganization.

- 1 4. The Commissioner's authority arises from RCW ch. 48.31C, the Holding  
2 Company Act for Health Care Service Contractors and Health Maintenance  
3 Organizations (the "HCA") with respect to Premera Blue Cross and LifeWise  
4 Health Plan of Washington. Premera affiliates, LifeWise Assurance Company and  
LifeWise Health Plan of Arizona, Inc., are covered by the Insurer Holding  
Company Act, ch. 48.31B RCW (the "IHCA").
- 5 5. Premera supplemented its Form A Statement on September 27, 2002 and October  
6 25, 2002. Premera filed an Amended Form A Statement, pursuant to the  
7 Commissioner's Twenty-Fifth Order and the agreement of the parties, on February  
8 5, 2004 ("Amended Form A Statement").
- 9 6. A detailed description of Premera's proposed reorganization can be found in  
10 Premera's Form A Statement and Amended Form A Statement. Both the original  
11 Form A Statement, as supplemented, and the Amended Form A Statement are part  
12 of the record in this proceeding and were admitted as hearing exhibits. *See*  
13 Commissioner's Exhibits 1 and 2, respectively.
- 14 7. The proposed reorganization, which would permit Premera to convert to a for-  
15 profit company, involves a series of transactions pursuant to which PREMIERA  
16 and Premera Blue Cross will convert their business form from Washington  
17 nonprofit corporations organized under Titles 24.06 and 24.03 of the RCW,  
18 respectively, to Washington for-profit business corporations organized under  
19 Title 23B of the RCW.
- 20 8. In the reorganization, a series of transfers will occur between the existing nonprofit  
21 companies and newly created for-profit corporations. As a result, control of  
22 Premera's current business operations would be transferred to the new for-profit  
23 entities, in exchange for the stock of those for-profit companies. After these  
24 transactions, the current nonprofit PREMIERA will dissolve and transfer its assets  
25 (consisting at the time of dissolution solely of stock in for-profit New PREMIERA)  
to two new foundations, pursuant to the terms of the Amended Form A Statement.
9. As a part of the reorganization, two charitable foundations (one in Washington and  
the other in Alaska) will receive 100% of the initial stock of New PREMIERA,  
which stock they would sell over time subject to certain restrictions. Proceeds  
from the sale of the initial New PREMIERA stock by the Washington Foundation  
and Alaska Health Foundation would fund charitable grants to promote the health  
of Washington and Alaska residents.
10. At the time of New PREMIERA's IPO, New PREMIERA will issue additional new  
shares to public investors for the purpose of raising capital for the company.
11. The HCA permits the Commissioner or his staff to conduct an investigation, order  
production of books and records, and retain experts to assist in the review and

1 investigation of the proposed transaction detailed in a Form A Statement. *See*  
2 RCW 48.31C.030-.040, .070; *see also* RCW 34.05.446; WAC 10-08-120.

3 12. The HCA allows for a hearing to be held by the Commissioner in connection with  
4 his review of the conversion. *See* RCW 48.31C.030. Such a hearing is conducted  
5 as an adjudicative proceeding, resulting in a final administrative order.

6 13. Accordingly, the Commissioner established a separation of functions within the  
7 OIC in this matter, confirmed his role as the administrative hearing officer for the  
8 hearing on Premera's Form A Statement, and authorized a separate agency staff  
9 review team ("OIC Staff") to hire various expert consultants to assist it in  
10 reviewing and evaluating the proposal.

11 14. The OIC Staff and their consultants conducted an extensive review of Premera's  
12 proposed reorganization over the course of almost two years. They requested and  
13 received over 40,000 pages of documents, and conducted numerous interviews of  
14 Premera's management and staff. The OIC Staff consultants issued reports on the  
15 original Form A Statement on October 27, 2003.

16 15. Premera also engaged independent experts to evaluate the Form A Statement.  
17 Those experts issued reports that reviewed Premera's proposal and responded to  
18 the reports of the OIC Staff's consultants on November 10, 2003.

19 16. In response to issues raised by the OIC Staff and its consultants in their expert  
20 reports, and pursuant to the Commissioner's Twenty-Fifth Order, Premera met  
21 with the OIC Staff and its consultants during December 2003 and January 2004 to  
22 discuss Premera's Form A Statement. The parties made substantial progress in  
23 addressing the concerns raised by the OIC Staff consultants regarding the original  
24 Form A Statement.

25 17. As a result of these discussions, Premera filed its Amended Form A Statement on  
February 5, 2004.

18 18. The Amended Form A Statement was subject to further extensive review by the  
19 OIC Staff's consultants. The OIC Staff's consultants filed reports on the Amended  
20 Form A Statement on February 27, 2004. Premera's experts filed reports on the  
21 Amended Form A Statement on March 5, 2004.

22 19. From May 3, 2004 through May 18, 2004, the Commissioner presided over the  
23 hearing on Premera's Amended Form A Statement. Over forty witnesses testified  
24 before the Commissioner, including the OIC Staff's consultants and Premera's  
25 experts. At the end of the testimony, OIC Staff presented its recommendation to  
the Commissioner. *See generally*, Report of Proceedings ("RP").

**Premera and The Board's Decision to Convert to a For-Profit Company**

20. Premera is and has been a nonprofit corporation engaged in a commercial service—namely, the provision of health care coverage to paying subscribers. Ex. P-7 (Barlow Pre-filed Responsive) p. 2; RP 125 (Barlow); RP 1260 (Steel). Premera does not solicit or receive charitable contributions, and it does not provide free or reduced-fee services. Ex. P-7 (Barlow Pre-filed Responsive) p. 2. It does not alter its prices depending upon a subscriber's ability to pay. Ex. P-7 (Barlow Pre-filed Responsive) p. 5; *see also* RP 124-25 (Barlow).
21. Premera is not a charity, nor does its Board consider the company to be a charity. RP 1260 (Steel); Ex. P-7 (Barlow Pre-filed Responsive) p. 2; RP 124-25 (Barlow); RP 97-98 (Jewell).
22. Premera is a commercial enterprise and a taxable provider of health care coverage to those who pay premiums for such coverage. Ex. P-84 (Steel Pre-Filed Direct) pp. 6-10, 13-15; Ex. P-7 (Barlow Pre-Filed Responsive) p. 2; Ex. P-88 (Steel Pre-Filed Responsive) p. 1-3 & n.2. Congress recognized this fact when, in 1986, it withdrew the federal income tax exemption previously enjoyed by Blue plans. Ex. P-10 (Report of E. Lewis Reid) pp. 4-5 & n.7; *see also* RP 1260 (Steel).
23. Premera has no owners. Ex. P-88 (Steel Pre-filed Responsive) p. 4; *cf.* RP 1261 (Steel). Major company decisions are made by the company's Board of Directors. *Cf.* RP 1272-73 (Steel).
24. The Premera Board unanimously decided to pursue conversion after an extensive due diligence process in which it explored capital-raising alternatives with the aid of outside experts. Ex. P-1 (Jewell Pre-filed Direct) p. 5; RP 1271-73 (Steel).
25. The decision to convert was made by the Premera Board, not by company management. RP 80-81 (Jewell); RP 1262 (Steel).
26. The credentials of Premera's Board and management team are excellent. Their competence, experience, and integrity are not in question. RP 2076-77 (Cantilo).
27. Premera's Board concluded that conversion, and remaining an independent, local company, is the best way to serve Premera's subscribers. Ex. P-1 (Jewell Pre-filed Direct) p.7.
28. The Premera Board made the decision to convert on the basis of sound business judgment regarding the best way to serve its members. *See generally* Ex. P-1 (Jewell Pre-filed Direct) pp. 3-4; Ex. P-57 (Fox Pre-filed Direct) pp. 8-9; RP 1218-19 (Fox).

**Premera is Capital Constrained**

29. Premera's business is very capital-intensive. RP 69 (Jewell); Ex. P-58 (Marquardt Pre-filed Direct) pp. 6-7; RP 1063 (Fahey). In addition to maintaining a prudent Risk Based Capital ("RBC") level, Premera, as a health plan, needs capital to meet its obligations to members, for expenditures to increase capacity, to grow its membership, to improve efficiency and to improve services and infrastructure. Ex. P-67 (NovaRest Report) pp. 1, 2, and 5; Ex. P-65 (Novak Pre-filed Direct) pp. 9-10; Ex. P-57 (Fox Pre-filed Direct) p. 8; Ex. P-58 (Marquardt Pre-filed Direct) pp. 6-7.
30. Premera is currently capital constrained. Ex. P-67 (NovaRest Report) pp. 2, 3 and 21; Ex. P-65 (Novak Pre-filed Testimony) pp. 5; RP 452 (Novak); Ex. P-46 (Milliman Report) p. 5; Ex. P-44 (Lusk Pre-filed Direct) p. 8. Capital constraints limit Premera's ability to grow. Ex. P-67 (NovaRest Report) pp. 20, 21; RP 461-62 (Novak).
31. The OIC Staff's actuarial consultant, Mr. Martin Staehlin, acknowledged that Premera had no "free capital" and hence was capital constrained. RP 1897-98 (Staehlin). *See also* RP 1390 (Koplovitz).
32. Being capital-constrained creates a number of problems. It means that a company starts making decisions based upon the effect of those decision on its capital level, instead of making them based on their impact on profitability, customer service and long-range efficiency or profitability. RP 459-462 (Novak).

**Premera's Capital Constraints Are Reflected in its RBC Level**

33. The Premera Board's decision to pursue conversion was informed by the capital constraints experienced by the company, as illustrated by Premera's RBC level.
34. Premera seeks access to equity capital to strengthen its capital reserves and to raise its RBC level to 500-600%. RP 118-19 (Barlow); RP 1218-19 (Fox); RP 1125 (Marquardt). The prudent minimum RBC level for a company such as Premera is 500%. Ex. P-65 (Novak Pre-filed Direct) pp. 8, 13; *see also* P-46 (Milliman Report) p. 5.
35. Premera's RBC is among the lowest of all Blue Cross Blue Shield licensees. In 2001, it was 30% below the system-wide average of 599%; in 2002, 35% below the system-wide average of 626%; and in 2003, 39% below the system-wide average of 712%. Exhibit S-2 (Blackstone Report on Valuation) p. 26; RP 1121 (Marquardt); RP 1384-85 (Koplovitz).
36. In 2002, Premera's RBC level was 406%. Ex. P-67 (NovaRest Report) pp. 5, 13, Appendix B; Ex. P-65 (Novak Pre-filed Testimony) pp. 8, 13; RP 453 (Novak).

1 This is close to the 375% Blue Cross Blue Shield Association's threshold level for  
2 early-warning monitoring. RP 453 (Novak).

3 37. The 2002 RBC level was the fourth lowest in comparison with other Blue Cross  
4 Blue Shield Association plans. Ex. P-67 (NovaRest Report) Appendix B. The  
5 other Blue Cross Blue Shield Association plans averaged an RBC level in excess  
6 of 600%. Ex. P-67 (NovaRest Report) p. 13; Ex. P-65 (Novak Pre-filed  
7 Testimony) p.13; RP 454 (Novak).

8 38. While Premera's RBC level of 433% in 2003 reflects a slight improvement in its  
9 RBC level, the RBC levels in 2003 of a number of other Blue Cross Blue Shield  
10 Association plans went up even more than Premera's and the average RBC level  
11 for all Blue Cross Blue Shield Association plans (712%) increased at a higher rate  
12 than Premera's. RP 117-18 (Barlow); RP 454-56 (Novak); RP 1121 (Marquardt).

13 39. Premera's goal of an RBC level of 500% to 600% is reasonable and necessary.  
14 Ex. P-67 (NovaRest Report) pp. 3, 8 and 26; Ex. P-65 (Novak Pre-filed Direct) p.  
15 13; RP 491 (Novak); Ex. P-44 (Lusk Pre-filed Direct) pp. 7-8.

16 **Conversion Would Strengthen Premera to the Benefit of its**  
17 **Subscribers and the Public Interest**

18 40. A higher RBC resulting from Premera's conversion and subsequent IPO would  
19 benefit Premera's subscribers by giving them greater security that their claims will  
20 be paid. RP 166 (Barlow); Ex. P-65 (Novak Pre-filed Testimony) p. 9; RP 1120  
21 (Marquardt).

22 41. Having additional capital will also enable Premera to grow and to offer its  
23 products and services to more of the insurance-buying public. RP 119-20  
24 (Barlow); Ex. P-58 (Marquardt Pre-filed Direct) pp. 6-7; RP 1120-21 (Marquardt);  
25 RP 1386 (Koplovitz).

42. Premera needs to continue to invest in information technology and innovative  
programs in order to compete with national, regional, and local providers of health  
insurance. Ex. P-68 (Smit Pre-filed) p. 3-7; RP 956-58 (Smit); RP 696-98  
(Donigan); Ex P-4 (Barlow Pre-filed Direct) p. 12-13; RP 120-21 (Barlow).

43. Having a broader base of subscribers will enable Premera to spread the costs of  
necessary investments in infrastructure and programs such as care facilitation,  
dampening upward pressures on premiums. RP 81-82 (Jewell); Ex P-4 (Barlow  
Pre-filed Direct) p. 13; RP 119 (Barlow); RP 1162-63 (Marquardt); RP 379-381  
(Gollhofer); RP 864-65 (Ancell); RP 1064 (Fahey).

**Premera's Board Explored All Reasonable Options for Raising Capital Before  
Settling on Conversion as the Best Choice for the Company**

44. Premera's Board of Directors conducted an extensive due diligence during which they explored all reasonable options for raising capital for the company. Ex. P-1 (Jewell Pre-filed Direct) pp. 5-7; RP 73-78 (Jewell); RP 1063-65 (Fahey); Ex. P-86 (Steel Report) pp. 2-8; Ex. P-84 (Steel Pre-filed Direct) pp. 17-20.
45. There are a number of potential ways for Premera to improve its RBC level: (a) becoming a public company and thereby obtaining access to the equity markets; (b) sale of the company or merger with another company; (c) sale of assets; (d) increasing profitability; and (e) use of debt, specifically surplus notes. Ex. P-67 (NovaRest Report) p. 6; Ex. P-65 (Novak Pre-filed Direct) pp. 10-13; RP 460-62 (Novak); RP 73-78 (Jewell).
46. The best way for Premera to improve its RBC level is to become a public company and raise capital through the equity markets. Ex. P-67 (NovaRest Report) p. 19; Ex. P-65 (Novak Pre-filed Direct) p. 14; RP 460, 468 (Novak).
47. A sale or merger is not a viable capital-raising alternative for Premera. Ex. P-1 (Jewell Pre-filed Direct) p. 6; Ex. P-67 (NovaRest Report) p. 16; Ex. P-65 (Novak Pre-filed Direct) p. 11; RP 464 (Novak).
48. Premera's significant assets are all integral components of the company's business strategy and a sale of any such assets will not be in furtherance of that strategy. Also, the sale of an asset is a one-time transaction and eventually the company runs out of assets to sell. Ex. P-1 (Jewell Pre-filed Direct) p. 6; Ex. P-67 (NovaRest Report) p. 16; Ex. P-65 (Novak Pre-filed Direct) p. 11; RP 463-64 (Novak).
49. Achieving increases in RBC levels through raising profits is a very long-term approach and would not lead to a significant increase in Premera's RBC level in the short run. Ex. P-67 (NovaRest Report) pp. 4, 5, and 17; Ex. P-65 (Novak Pre-filed Direct) p. 12; RP 466 (Novak).
50. Milliman's study determined that Premera's margins were not sufficient to meaningfully increase its RBC level. Ex. P-46 (Milliman Report) pp. 5, 16; Ex. 44 (Lusk Pre-filed Direct) pp. 1-2, 7-8; RP 651-52 (Lusk).
51. Surplus notes, which are the only debt instruments that can increase RBC, are not a viable capital-raising alternative for Premera. Surplus notes are very difficult to obtain and can be costly a form of capital. They are an unattractive option, due to required regulatory approvals and other conditions that may be imposed. The amount of surplus debt that counts as statutory capital is limited to a small percentage of existing statutory capital. Ex. P-1 (Jewell Pre-filed Direct) p. 6; Ex.

1 P-67 (NovaRest Report) p. 18; Ex. P-65 (Novak Pre-filed Direct) pp. 12-13; RP  
2 465-66 (Novak).

3 **Premera's Conversion and Subsequent IPO is a Sound Business Proposal**

- 4 52. Both the OIC Staff's consultants and Premera's experts agree that Premera is an  
5 attractive IPO candidate. It is strong in the fundamentals that investors are looking  
6 for, including growth prospects and sound management. Ex. P-76 (Kinkead Pre-  
7 filed Direct) pp. 6-7; Ex. P-67 (Banc of America Report) p. 6; Ex. P-80 and Ex. P-  
8 102 (Alderson Smith Dep.) p. 308; RP 1388-89 (Koplovitz).

9 **Premera's Conversion Satisfies Registration and Form D Requirements.**

- 10 53. Post-conversion, Premera would undisputedly satisfy all applicable registration  
11 requirements. Ex. S-31 (Cantilo & Bennett Report) p. 28, n.63; Ex. S-33 (Cantilo  
12 & Bennett Supp. Report, Exec. Summ.) p. 9.
- 13 54. In conjunction with the Conversion, Premera has proposed certain inter-company  
14 transactions that are governed by a separate provision of the HCA (RCW  
15 48.31C.050), referred to as "Form D Transactions."
- 16 55. The OIC Staff consultants confirm that the only Form D Transaction issue  
17 concerns the absence of a provision in the Guaranty Agreement between New  
18 PREMERA and New Premera Blue Cross. RP 2078-80, 2041-42 (Cantilo); Ex. S-  
19 33 (Cantilo Report) pp. 9-10. Such a provision is contained in the Guaranty  
20 Agreement between New PREMERA and New Premera Blue Cross Blue Shield of  
21 Alaska. Premera has committed to amending the New Premera Blue Cross  
22 Guarantee Agreement to include such a replacement coverage provision. RP  
23 1141-42 (Marquardt).

24 **Premera's Proposal was not Motivated by a Desire to Enrich Management**

- 25 56. The executive compensation aspects of Premera's conversion proposal have  
undergone extensive scrutiny by an outside expert with access to the company's  
records and personnel; this scrutiny revealed no evidence that the conversion was  
motivated by concerns regarding executive compensation. Ex. P-49 (Furniss Pre-  
filed Direct) pp. 5-10, 16-17; Ex. P-51 (Towers Perrin Report) pp. 3 and 10. The  
OIC Staff's consultant ultimately reached a similar conclusion. S-33 (Cantilo  
Supp. Report) p. 60.
57. Evidence at the hearing confirmed that Premera's conversion was not motivated by  
a desire to increase executive compensation. Indeed, Board members testified to  
the contrary in no uncertain terms. See RP 81 (Jewell) ("I am very sensitive to the  
issue of executive compensation and if I thought for a minute that there was any  
personal motivation on the part of the executives here, I would not support it. That  
is absolutely not part of our motivation whatsoever.").



1 58. Nor is there any evidence that the conversion was motivated by a desire to  
2 entrench the Board or management. RP 1272-73 (Barlow).

3 **How Premera's Compensation Committee Establishes Executive Compensation**

- 4 59. Oversight of Premera's executive compensation is the responsibility of the  
5 Compensation Committee of the Board. Ex. P-48 (Fahey Pre-filed Direct) pp. 3-5;  
6 Ex. P-49 (Furniss Pre-filed Direct) pp. 3-4. The Compensation Committee is  
7 composed entirely of outside directors. Ex. P-48 (Fahey Pre-filed Direct) pp. 4-6;  
8 RP 1045-46, 1049, 1052-53 (Fahey).
- 9 60. There are a number of procedures in place to ensure that the Compensation  
10 Committee is independent from Premera's management. Ex. P-48 (Fahey Pre-  
11 filed Direct) pp. 4-5; RP 1049, 1052-53 (Fahey). Premera's Board and its  
12 Compensation Committee exercise an appropriate degree of oversight regarding  
13 executive compensation. Ex. P-51 (Towers Perrin Report) p. 11.
- 14 61. The Compensation Committee is advised by a national compensation consulting  
15 firm, Mercer Human Resources Consulting ("Mercer Consulting"). Ex. P-48  
16 (Fahey Pre-filed Direct) pp. 5-6; RP 1045-46 (Fahey). Mercer Consulting is  
17 nationally recognized and has a good reputation. Ex. P-186 (Nemerov Deposition)  
18 p. 22. The approach Mercer Consulting takes is appropriate and professional. Ex.  
19 P-51 (Towers Perrin Report) pp. 4 and 11-12; RP 743 (Furniss). PwC's  
20 consultant, Mr. Nemerov, had no criticism of Mercer Consulting's work. Ex. P-  
21 186 (Nemerov Deposition) p. 22. The Mercer Consulting is engaged by the  
22 Compensation Committee, works directly with the Committee, and the relationship  
23 between Mercer Consulting and the Compensation Committee is a healthy one.  
24 Ex. P-51 (Towers Perrin Report) pp. 11-12.
- 25 62. When it is deciding executive compensation issues, the Compensation Committee  
regularly meets in executive session without company executives present. Ex. P-  
48 (Fahey Pre-filed Direct) pp. 4-5; RP 740-41 (Furniss).
63. Premera's compensation philosophy is determined by the Board and the  
Compensation Committee. Ex. P-48 (Fahey Pre-filed Direct) pp. 3-5; Ex. P-51  
(Towers Perrin Report) p. 10; RP 1044 (Fahey); RP 737 (Furniss). The key  
elements of Premera's compensation philosophy are: (i) a peer group, or reference  
group for benchmarking purposes, of health insurance companies of like size, both  
for-profit and not-for-profit; (ii) pay at the median for target performance of this  
peer group except where certain positions require extraordinary skills or talent; and  
(iii) benchmarking of executive positions based on actual job responsibilities, not  
simply job titles. Ex. P-51 (Towers Perrin Report) p. 10; RP 738-39 (Furniss).  
Premera's compensation philosophy is conservative and reasonable for a company  
in its industry. P-51 (Towers Perrin Report) pp. 4 and 10; RP 740 (Furniss).

64. Conversion will not change Premera's compensation philosophy. RP 81 (Jewell); RP 1053-54 (Fahey).

### **Current Executive Compensation**

65. Premera's current executive compensation levels are reasonable and appropriate. Ex. P-51 (Towers Perrin Report) pp. 17, 33-38; Ex. P-49 (Furniss Pre-filed Direct) p. 1, 9-10. The peer group that Premera uses is an appropriate one. Ex. P-51 (Towers Perrin Report) p. 17. Premera's executives are paid salary, annual incentives and long-term incentive consistent with its philosophy. Ex. P-51 (Towers Perrin Report) p. 15; Ex. P-49 (Furniss Pre-filed Direct). Pay is at the median of the market for the job functions performed. Ex. P-51 (Towers Perrin Report) pp. 14-17, 33-38; RP 745-46 (Furniss). Premera's compensation approach takes into account the actual responsibilities of the executives, not just their job titles, as well as the specific expertise of the executives and the needs of the company. Ex. P-49 (Furniss Pre-Filed Direct) pp. 10-12.

66. Premera's Annual Incentive Plan is very conservative in design. It establishes a target and a minimum based on operating income of the company for the year; if the minimum operating income level is not met, no award of any kind is granted. To the extent that non-financial performance objectives are not met, the annual award is reduced. Ex. P-52 (Towers Perrin Supplemental Report) pp. 5-6.

67. Premera's Long Term Incentive Plan is consistent with market practice. Ex. P-51 (Towers Perrin Report) pp. 18-21.

68. The defined benefit supplemental executive retirement plan ("DB SEEP") and the defined contribution supplemental executive retirement plan ("DC SEEP") are at or below market competitive practices. Ex. P-52 (Towers Perrin Supplemental Report) pp. 8-9; Ex. P-53 (Furniss Pre-Filed Responsive) p. 6; RP 1600 (Nemerov).

### **Post-Conversion Executive Compensation**

69. Premera's proposed post-conversion compensation plan is reasonable and appropriate. Ex. P-51 (Towers Perrin Report) p. 6, 21-22; Ex. P-52 (Towers Perrin Supplemental Report) p. 5-14; Ex. P-49 (Furniss Pre-filed Direct) pp. 1, 12; RP 747 (Furniss).

70. Premera's post-conversion Compensation Committee will be composed entirely of independent directors, consistent with New York Stock Exchange requirements. RP 1052-53, 1057-59, 1094-95 (Fahey). Public companies are under a great deal of scrutiny, and Premera's Compensation Committee and board will continue to exercise appropriate oversight. RP 748 (Furniss); RP 1059-60, 1099-1100 (Fahey).

- 1 71. Premera's proposed equity incentive plan, combined with the limits of Exhibit G-  
2 10 to the Amended Form A, provides for strict limits on stock options that can be  
3 granted in the aggregate and to the Chief Executive Officer and Executive Vice  
4 Presidents for the first three years after Premera's conversion. Commissioner's Ex.  
5 2 (Amended Form A) at Exhibit G-10. No stock-based grants can be made to  
6 officers or directors for one year after conversion. *Id.*
- 7 72. Restricted stock, if any, can be granted only within the limits in Exhibit G-10 and  
8 only in lieu of cash under Premera's long-term incentive plan. Stock options  
9 granted during the three-year period after conversion must have an exercise price  
10 at fair market value on the date of grant and must vest over four years at 25% per  
11 year for employees and over three years at 33-1/3% per year for directors. *See*  
12 Commissioner's Ex. 2 (Amended Form A) at Exhibit G-10.
- 13 73. Premera's equity incentive plan will align the interests of management with those  
14 of shareholders, but at the same time is conservative and consistent with market.  
15 Ex. P-49 (Furniss Pre-Filed Direct) pp. 12-13; RP 1604 (Nemerov). Mr. Nemerov  
16 agrees that the equity incentive plan for Premera's executives is appropriate as is  
17 the stock option program for Premera's directors (Nemerov hearing testimony, RP  
18 1630). Any additional restrictions on the equity incentive plan would interfere  
19 with appropriate alignment of shareholders and management and would place  
20 Premera at a competitive disadvantage. Ex. P-49 (Furniss Pre-filed Direct) pp. 13-  
21 14; Ex. P-52 (Towers Perrin Supp. Report) pp. 15-16.
- 22 74. Compared to other public companies, Premera's post-conversion salaries, annual  
23 incentives, and long-term incentives for its executive officers are at or below  
24 market. Ex. P-49 (Furniss Pre-Filed Direct) pp. 13-14.
- 25 75. Compared to its chosen peer group of health care companies, Premera's post-  
conversion compensation plan is reasonable and appropriate. Ex. P-49 (Furniss  
Pre-filed Direct) p. 13; Ex. P-53 (Furniss Pre-filed Responsive) pp. 7-9; RP 746-48  
(Furniss).
76. A minimum shareholder return as a performance measure in the long-term  
incentive plan is not a typical provision for such plans offered by Premera's peer  
group. RP 1645-46 (Nemerov).
77. Exhibit E-8 of the Amended Form A Statement contains several compensation  
assurances that were approved by the OIC Staff and its consultants. These  
assurances help assure that the interests of the Board and management are aligned  
with the interests of Premera's members and its shareholders. However, any  
additional assurance or any lengthening of the terms of the assurances are not  
necessary, would not improve said alignment, and would be harmful to Premera's  
ability to compete. Ex. P-49 (Furniss Pre-filed Direct) pp. 13-15; Ex. P-52  
(Towers Perrin Supp. Report) pp. 3-14, 15-16.

**Premera's Conversion Will Not Cause Anticompetitive Effects**

78. Nothing about the structure or the conditions of the market will change as a result of the conversion. Ex. P-176 (Leffler Dep.) p. 86:5-87:8; Ex. S-17 (Leffler Report) p. 43; RP 548 (McCarthy); Ex. P-25 (McCarthy Pre-filed Responsive) p. 13.
79. The relevant market for the sale of health insurance is the market for all health insurance products sold by commercial insurers in the state of Washington. RP 523-24 (McCarthy); Ex. P-20 (McCarthy Pre-filed Direct) pp. 5-6; Ex. P-22 (NERA Report) pp. ES-2 and 10-18.
80. There are no significant regulatory or operational barriers to inhibit competing sellers of health insurance in Washington from expanding into new product lines or expanding into new geographic areas in the state of Washington. Ex. P-176 (Leffler Deposition) p. 101:7-18; RP 1792-93 (Leffler); RP 524-25 (McCarthy); Ex. P-22 (NERA Report) pp. 21-26.
81. There are no significant regulatory or operational barriers to inhibit sellers of health insurance not presently in Washington from entering Washington to sell health insurance. Ex. P-22 (NERA Report) pp. 21-22; Ex. P-42 (Donigan Pre-filed Direct), pp. 7-8; Ex. P-37 (Ancell Pre-filed Direct) pp. 10-11.
82. Health insurance in the state of Washington is sold in an effectively competitive market. Exhibit P-176 (Leffler Dep.) p. 145:9-12; Ex. P-22 (NERA Report) p. ES-4.
83. Premera does not have market power in the sale of health insurance in the state of Washington. RP 527-31 (McCarthy); Ex. P-20 (McCarthy Pre-filed Direct) pp. 6-7; Ex. P-22 (NERA Report) pp. ES-3 and ES-4.
84. The relevant geographic market for the purchase of provider services is at least as large as metropolitan statistical areas or health service areas, and even could be as large as Western Washington and Eastern Washington separately. RP 532 (McCarthy); Ex. P-20 (McCarthy Pre-filed Direct) p. 8; Ex. P-22 (NERA Report) pp. 37-38.
85. The purchase of provider services in Western Washington is highly competitive. RP 1779 (Leffler); Ex. S-17 (Leffler Report) p. 23; Ex. P-22 (NERA Report) p. 39; Ex. P-20 (McCarthy Pre-filed Direct) p. 11.
86. Premera's provider reimbursement rates are not significantly lower in Eastern Washington than in Western Washington. RP 537-39 (McCarthy); P-20 (McCarthy Pre-filed Direct) p. 10-11; Ex. P-22 (NERA Report) pp. 47-54.

- 1 87. Premera does not have market power for the purchase of provider services in any  
2 geographic market in the state of Washington. RP 534, 539-540 (McCarthy); Ex.  
P-20 (McCarthy Pre-filed Direct) p. 8-11; Ex. P-22 (NERA Report) pp. 54-59.
- 3 88. There is no evidence that Premera has charged supracompetitive prices in the sale  
4 of health insurance in Washington. RP 1782 (Leffler); RP 528-30 (McCarthy);  
5 Ex. P-22 (NERA Report) pp. 28-29.
- 6 89. There is no evidence that Premera or any other seller of health insurance has  
7 supracompetitive profit margins. RP 1782 (Leffler); RP 531 (McCarthy); Ex. P-22  
(NERA Report) pp. 30-32.
- 8 90. Premera has no ability to exercise market power in the purchase of provider  
9 services in the identified fourteen counties in Eastern Washington to impact  
10 provider reimbursement. The conversion will have no effect on the exercise of  
11 such market power. RP 1781-82 (Leffler).
- 12 91. Market realities strongly encourage Premera to maintain its statewide provider  
13 network and refrain from withdrawing from any county, or from any line of  
14 business statewide. RP 540-43 (McCarthy).
- 15 92. The markets that Premera competes in for health insurance and provider services  
16 are competitive in both structure and performance. Ex. P-25 (McCarthy Pre-filed  
17 Responsive) p. 2.
- 18 93. The PricewaterhouseCoopers Economic Impact model does not establish that  
19 premiums will increase or provider reimbursements will decrease as a result of the  
20 conversion because it has no predictive value. RP 1991-92 (Gold); Exs. P-156 and  
21 P-157 (email correspondence); RP 1730-31 (Hunt); Ex. 25 (McCarthy Pre-filed  
22 Responsive) p. 17.
- 23 94. The model is not a helpful analytical tool for the following reasons: It is based on  
24 assumptions and not on an analysis of realistic competitive conditions. It assumes,  
25 without analytical support, that areas in which Premera purportedly has high  
market share will be the places that suffer premium increases and reimbursement  
reduction. The model does not account for the regulatory constraints on raising  
premiums imposed by state law. Ex. P-25 (McCarthy Pre-filed Responsive) pp.  
16-17; Ex. P-177 (Leffler Dep.) p. 262; RP 1991-99 (Gold).
95. Other than a relatively small increase in Alaska premium tax, which would not  
impact Washington subscribers, the conversion is unlikely to generate changes in  
Premera's premium rates. Ex. P-46 (Milliman Report) pp. 5, 6, 16-21; Ex. P-44  
(Lusk Pre-filed Direct) pp. 1, 6-7; RP 649-53 (Lusk).
96. Indeed, modeling of premium rates with and without conversion indicate that, in  
the "with conversion" case, premiums may be 0.5% less than in the "without

conversion" case. Ex. P-46 (Milliman Report) p. 5; Ex. P-44 (Lusk Pre-filed Direct) pp. 1 and 6-7; RP 649-53 (Lusk).

97. The Washington Economic Impact Assurances should not be extended beyond the current two year term. Ex. P-44 (Lusk Pre-filed Direct) p. 8. Premera's competitors will have an unfair competitive advantage as a result of these assurances and to extend the assurances for a time period longer than two years would be an unsound business practice and imprudent. Ex. P-47 (Milliman Supplemental Report) pp. 1-2; Ex. P-44 (Lusk Pre-Filed Direct) p. 8; RP 653-55 (Lusk); Ex. P-24 (NERA Supplemental Report) pp. 2-5.

#### **The Conversion Would Result In the Creation of Two Charitable Foundations**

98. The conversion proposal unlocks the potential of Premera's assets to address unmet health needs, by creating large new sources of philanthropic health funding. Ex P-4 (Barlow Pre-filed Direct) p. 13-14; Ex. P-8 (Reid Pre-filed Direct) pp. 1-2; RP 293-96, 329 (Reid); RP 1563-64 (Lundy); RP 1065-66 (Fahey); RP 1270-71 (Steel).
99. Washington has a large number of unmet health needs. Ex. P-15 (Dingfield Pre-filed) pp. 1, 8-9; Ex. P-8 (Reid Pre-filed Direct) pp. 6-7. Funds from a philanthropic organization such as the Washington Foundation could be deployed to help address such needs. Ex. P-15 (Dingfield Pre-filed) pp. 11-13; Ex. P-8 (Reid Pre-filed Direct) pp. 1-2; Ex. P-1 (Jewell Pre-filed Direct) p. 8-9; RP 78, 84-85 (Jewell).
100. Premera and the OIC Consultants agree that the preferred tax exempt classification for the Foundations would be as IRC sec. 501(c)(4) organizations. Ex. P-12 (Reid Pre-filed Responsive) p. 9-12; P-13 (Lundy Deposition Excerpts) pp. 86-87, 122-135. In the event that the IRS does not recognize the Foundations as 501(c)(4) organizations, however, the OIC Consultants confirm that the classification would otherwise be as IRC sec. 501(c)(3) organizations and that such classification is acceptable. RP 1566 (Lundy).

#### **The Restrictions upon the Foundations Are Appropriate and Protect the Value of the Stock They Will Hold**

101. The New PREMERA stock held by the two Foundations is subject to certain restrictions because the Foundations will have significant holdings of such stock. These restrictions, primarily voting and divestiture requirements, are necessary for the orderly selldown and voting of the stock and will not degrade the value of the Foundations' stock when sold on the market. *See generally* Ex. P-78 (Banc of America Supp. Report) pp. 7-10; Ex. P-84 (Steel Pre-filed Direct) pp. 23-24; RP 1274-78 (Steel).

- 1 102. Some restrictions on the voting and selling rights of the foundations are necessary  
2 in order for New PREMERA to maintain the Blue Cross Blue Shield license, an  
3 asset with undisputed value to the company. RP 1469-70 (Alderson Smith); RP  
4 125-31 (Barlow); RP 2478-80 (Barlow); Ex. P-77 (Banc of America Report  
5 Appendix) p. 31; Ex. P-78 (Banc of America Supp. Report) pp.7-8.
- 6 103. Restrictions upon stock in the hands of the foundations can also serve to increase  
7 the value of the stock by giving other investors assurance that the stock will be  
8 disposed of in an orderly fashion and that philanthropic organizations will not be  
9 interfering in the management of an insurance company. Ex. P-78 (Banc of  
10 America Supp. Report) p. 9; RP 880-882, 887-89 (Kinhead); RP 1278 (Steel); RP  
11 1481-82 (Alderson Smith).
- 12 104. The restrictions on the New PREMERA initial stock held by the Foundations will  
13 not apply to subsequent purchasers of such shares, and therefore do not lessen the  
14 value of those shares as held by public investors. RP 1484-85 (Alderson Smith).
- 15 105. Premera never committed to giving unrestricted stock to the foundations. The  
16 Form A Statement and Amended Form A Statement set forth the terms and  
17 conditions of the conversion, including the restrictions. *See* Commissioners Exs. 1  
18 and 2. If Premera were to provide unrestricted stock, the value of such shares  
19 would be less than the restricted stock. RP 2469-70 (Steel); *see also* RP 1274-78  
20 (Steel).

21 **The Tax Consequences of Conversion Do Not Constitute a Basis for Disapproval**

- 22 106. Premera Blue Cross is eligible to receive a special deduction afforded to Blue  
23 Cross Blue Shield plans under Section 833(b) of the Internal Revenue Code.  
24 Premera Blue Cross may lose the 833(b) special deduction if it undergoes a  
25 material change in structure or operations. Premera Blue Cross has been advised  
by its external tax advisers that the Conversion more likely than not will not  
terminate the use of the 833(b) special deduction. RP 2477-78 (Barlow).
107. The OIC staff's consultants concluded that it is not certain that Premera Blue  
Cross would not be able to maintain the 833(b) special deduction. They testified,  
moreover, this is an unsettled area of tax law; Premera has substantial arguments  
to support its position that it should be able to retain the deduction; and the  
outcome of that question may not be known for many years. RP 1539 (Ashley).  
Moreover, even though they assumed (as a worst-case scenario) that the deduction  
would be lost, the investment bankers opined that Premera would be an attractive  
investment. RP 1546 (Ashley), 1388-89 (Koplovitz).
108. The Conversion will qualify for tax-free treatment pursuant to the application of  
Sections 351 and 368 of the Internal Revenue Code of 1986, as amended. *See* Ex.  
P-64 (Tax Opinion). One of the transactions of the Conversion, which results in  
New Premera Blue Cross Blue Shield of Alaska becoming a direct subsidiary of

1 New PREMIERA, should qualify as a tax-free distribution pursuant to Section 355  
2 of the Internal Revenue Code, and no income, gain, or loss should be recognized  
3 by Premera or its affiliates resulting therefrom. *Id.* The Conversion should not  
4 cause Premera or New Premera to undergo an "ownership change" as such term is  
5 defined in Section 382(g) of the Internal Revenue Code. *Id.* The OIC Staff's  
6 consultants have concluded that reliance on the Ernst & Young opinions is not  
7 unreasonable. RP 1538 (Ashley).

8 **The Amended Form A Provides a Mechanism for the Transaction**  
9 **to Proceed While the States Determine the Allocation of Stock**  
10 **As Between the Washington and Alaska Foundations**

11 109. The Amended Form A contemplates two foundations as the recipients of the initial  
12 New PREMIERA stock but does not allocate the stock as between them. It is for  
13 the states to determine the appropriate allocation between Washington and Alaska.  
14 *Cf.* Ex. S-4 (Blackstone Supp. Report on Valuation) p. 11; RP 1476 (Alderson  
15 Smith).

16 110. If the states cannot reach complete agreement, the Amended Form A Statement  
17 provides a means whereby the transaction can proceed while the allocation is  
18 being finally resolved. Exhibit G-22 to the Amended Form A, the Unallocated  
19 Shares Escrow Agent Agreement ("USEAA"), establishes a way to hold and  
20 manage any shares that remain in dispute between the states until said dispute is  
21 resolved. Premera's and the OIC Staff's experts agree that such a mechanism is  
22 necessary. Ex. S-4 (Blackstone Supp. Report on Valuation) p. 11; RP 1476  
23 (Alderson Smith); Ex. P-84 (Steel Pre-filed Direct) p. 26; Ex. P-78 (Banc of  
24 America Securities Supp. Report) p. 10.

25 111. The USEAA will not go into effect unless the states cannot agree upon their  
respective allocation percentage. The USEAA provides that the escrow agent will  
hold only the portion of shares that remain in dispute, and that the agent will  
distribute those shares and terminate the escrow whenever there is agreement upon  
the final allocation. *See* Commissioner Ex. 2 (Amended Form A Statement,  
Exhibit G-22, sec. 2); RP 1140-41 (Marquardt); RP 1561 (Lundy).

**CONCLUSIONS OF LAW**

**Jurisdiction and Statutory Standards**

1. The Commissioner's evaluation of the conversion of Premera to for-profit status is governed by the standards set forth in RCW 48.31C.030.
2. The allocation of shares between the Foundations are not part of the HCA or IHCA and cannot be decided in this proceeding.



1 3. Charitable trust issues regarding Premera's assets or the review and assessment of  
2 the transfer of "fair market value" or "fair value" are not part of the HCA or IHCA  
3 and cannot be a basis for denying or conditioning approval of Premera's  
4 application.

4 4. The HCA presumes that an acquisition of control, such as Premera's conversion, is  
5 acceptable, for it mandates that the Commissioner "shall approve" the transaction  
6 in the absence of specific findings.

6 5. The HCA provides limited and specific criteria pursuant to which the  
7 Commissioner may disapprove the conversion. The HCA allows the  
8 Commissioner to disapprove the conversion only if New PREMERA cannot  
9 satisfy the registration requirements for a health carrier or if there is "substantial  
10 evidence" that the conversion is anticompetitive.

9 6. Specifically, RCW 48.31C.030(5)(a) states:

11 The commissioner shall approve an acquisition of control referred to in  
12 subsection (1) of this section unless, after a public hearing, he or she finds  
13 that:

13 (i) After the change of control, the domestic health carrier  
14 referred to in subsection (1) of this section would not be  
15 able to satisfy the requirements for registration as a health  
16 carrier;

16 (ii) The antitrust section of the office of the attorney general and  
17 any federal antitrust enforcement agency has chosen not to  
18 undertake a review of the proposed acquisition and the  
19 commissioner pursuant to his or her own review finds that  
20 there is substantial evidence that the effect of the acquisition  
21 may substantially lessen competition or tend to create a  
22 monopoly in the health coverage business.

21 (emphasis added).

22 **There is no Basis For Disapproval of the Transaction Under the HCA**

23 7. In this case, the HCA prohibits disapproval of the Conversion unless the  
24 Commissioner makes a finding that (1) New PREMERA will not be able to satisfy  
25 the requirements for registration as a health carrier, or (2) the Conversion will have  
an anticompetitive impact on the market for health coverage.

8. There is no legal or factual basis in the record for either of the findings required  
for disapproval.

- 1 9. Subsection 5(a)(i) of the HCA sets forth the first ground for disapproving a  
2 Form A: "After the change of control, the domestic health carrier [control of  
3 which is being acquired] would not be able to satisfy the requirements for  
4 registration as a health carrier[.]"
- 5 10. Premera undisputedly satisfies all applicable registration requirements. Ex. S-31  
6 (Cantilo & Bennett Report) p. 28, n.63; Ex. S-33 (Cantilo & Bennett Supp. Report,  
7 Exec. Summ.) p. 9. There is no basis in the record for the finding required to  
8 disapprove the conversion under RCW 48.31C.030(5)(a)(i).
- 9 11. Secondly, RCW 48.31C.030(5)(a)(ii) directs the Commissioner, absent  
10 intervention by state or federal antitrust authorities, to examine a Form A  
11 transaction for antitrust injury. The HCA establishes a stringent standard for the  
12 Commissioner to find competitive harm: he must find substantial evidence that  
13 the conversion may substantially lessen competition or tend to create a monopoly  
14 in order to disapprove under this section.
- 15 12. The conversion will not lessen competition or tend to create a monopoly in the  
16 health coverage business and there is no basis to make the finding required under  
17 RCW 48.31C.030(5)(a)(ii) to disapprove the conversion.

18 **The Factors Enumerated Under RCW 48.31C.030(5)(a)(ii)(C) Do Not Apply**  
19 **Unless There Is an Anticompetitive Effect, and They Do Not Establish**  
20 **A Basis for Disapproval on the Facts of this Case**

- 21 13. As a subset of the anticompetitive test, the HCA lists four more criteria: (1)  
22 whether the financial condition of the acquiring party might jeopardize the  
23 financial stability of the health carrier or prejudice the interest of its subscribers;  
24 (2) whether plans to make material changes to the corporate structure of the health  
25 carrier are unfair and unreasonable to subscribers and not in the public interest; (3)  
whether the competence, experience, and integrity of the persons who would  
control the health carrier are such that it would not be in the interest of subscribers  
and the public to permit the acquisition; and (4) whether the acquisition is likely to  
be hazardous or prejudicial to the insurance-buying public. See RCW  
48.31C.030(5)(a)(ii)(C)(I) – (IV).
14. These factors are not relevant unless an anticompetitive injury is first  
demonstrated.
15. Even if the factors listed in RCW 48.31C.030(5)(a)(ii)(C) are applied  
independently, the record does not contain the evidence necessary for a finding  
that any of these factors is present.

1 16. Therefore, there is no basis for disapproval of the Conversion under RCW  
2 48.31C.030(5)(a)(ii)(C).

3 **The Conversion Will Strengthen Premera's Financial Condition**

4 17. Subsection 5(a)(ii)(C)(I) asks whether the financial condition of the acquiring  
5 entity will "jeopardize the financial stability of the health carrier, or prejudice the  
6 interest of its subscribers[.]"

7 18. New PREMERA's financial condition post-conversion will not jeopardize the  
8 financial stability of the company or prejudice the interest of its subscribers. At  
9 conversion, New Premera will have essentially the same assets and liabilities  
10 Premera currently holds and post-IPO New Premera will have a stronger balance  
11 sheet and a greater RBC level. There is no basis for disapproval under this  
12 subsection.

13 **Premera's Proposal is Not Unfair and Unreasonable to its Subscribers**  
14 **And is Not Contrary to the Public Interest**

15 19. Subsection 5(a)(ii)(C)(II) of the HCA asks whether the conversion is unfair and  
16 unreasonable to Premera subscribers and not in the public interest.

17 20. The standard focuses upon the interests of subscribers, as do all of the factors  
18 enumerated in subsection 5(a)(ii)(C). *See also* RCW 48.01.030.

19 21. In order to disapprove under this section, there must be evidence that the  
20 conversion results in changes that are both "unfair and unreasonable to  
21 subscribers" and "not in the public interest." *See HJS Dev., Inc. v. Pierce County*,  
22 148 Wn.2d 451, 473 n.94, 61 P.3d 1141 (2003) ("[o]rdinarily, the word 'or' does  
23 not mean 'and' unless there is clear legislative intent to the contrary. Statutory  
24 phrases separated by the word 'and' generally should be construed in the  
25 conjunctive.") (citations omitted).

22 22. The conversion will not result in an increase in premiums above competitive  
23 levels.

21 23. The conversion will not result in decreased reimbursements to providers below  
22 competitive levels.

23 24. The conversion will not affect access to health insurance or health care providers.

24 25. Premera's post-conversion premium rates will not, as a result of the conversion, be  
25 unfair or unreasonable to Premera's subscribers, nor will they be not in the public  
interest.

1 26. There is no evidence that the conversion is unfair and unreasonable to Premera  
2 subscribers and not in the public interest. There is no basis for disapproval under  
3 this subsection.

4 **There is No Evidence that the Competence, Experience, and Integrity of Premera's  
5 Board and Management are Contrary to the Interests of Subscribers and the Public**

6 27. Subsection 5(a)(ii)(C)(III) asks whether "[t]he competence, experience, and  
7 integrity of those persons who would control the operation of the health carrier are  
8 such that it would not be in the interest of subscribers of the health carrier and of  
9 the public" to permit the conversion.

10 28. The directors of non-profits and for-profits essentially share the same standard of  
11 care under Washington law. Both non-profit and for-profit directors must look to  
12 the "best interest of the corporation." *Compare* RCW 24.06.153(1) (non-profit  
13 statute for PREMERA) *and* RCW 24.03.127 (non-profit statute for Premera Blue  
14 Cross) *with* RCW 23B.08.300(1) (for-profit statute).

15 29. The competence, experience, and integrity of Premera's Board and management  
16 are such that it would be in the interest of Premera's subscribers and of the public  
17 to permit the conversion.

18 30. There is no basis in the record for a finding supporting disapproval under this  
19 subsection.

20 **There is No Basis to Find That the Conversion Is "Likely to be Hazardous or  
21 Prejudicial to the Insurance-Buying Public"**

22 31. The last of the criteria listed under RCW 48.31C.030(5)(a)(ii)(C) focuses on the  
23 likelihood that the conversion will harm potential customers as well as current  
24 subscribers.

25 32. In this case there is no evidence to suggest such harm. To the contrary, an effect  
of conversion will be to give Premera more capital to support a larger customer  
base with competitively priced products. The Conversion is therefore likely to be  
beneficial to the insurance-buying public.

33. The conversion will not result in an increase in premiums above competitive  
levels, and will not be hazardous or prejudicial to the insurance-buying public.

34. The conversion will not result in decreased reimbursements to providers below  
competitive levels, and will not be hazardous or prejudicial to the insurance-  
buying public.

1 35. The conversion will not affect access to health insurance or health care providers,  
2 and will not be hazardous or prejudicial to the insurance-buying public.

3 36. There is no basis in the record for a finding supporting disapproval under this  
4 subsection.

5 **Other Standards, to the Extent They Apply, Are Met**

6 37. A separate provision of the HCA, RCW 48.31C.050, establishes requirements for  
7 transactions within a health carrier holding company system (i.e., Form D  
8 transactions). In conjunction with the Conversion, Premera has proposed certain  
inter-company transactions that are governed by Form D standards and  
requirements.

9 38. Those inter-company transactions proposed as part of the Amended Form A  
10 Statement, including the specific change to the Guaranty Agreement proposed by  
Premera, are fair and reasonable and meet the standards of RCW 48.31C.050.

11 39. To the extent that the standards of RCW ch. 48.31B apply, due to the presence of  
12 for-profit Premera affiliates, those standards are met here.

13 **Proof of the Business Necessity for Conversion is Not a Factor Under the HCA, but,**  
14 **Even if it were, Premera's Business Goals Are Reasonable and the Premera Board**  
15 **Exercised its Sound Business Judgment in Making the Decision to Convert**

16 40. Premera's goal of seeking an RBC level of 500% to 600% is reasonable and  
prudent.

17 41. Premera's goal of seeking an RBC level of 500% to 600% is not unfair or  
18 unreasonable to Premera's subscribers, nor is it contrary to the public interest.  
19 Rather, Premera's RBC goal is to the benefit of Premera's subscribers and is in the  
public interest.

20 42. Premera's goal of seeking an RBC level of 500% to 600% is not hazardous or  
21 prejudicial to the insurance-buying public. To the contrary, it is to the benefit of  
the insurance-buying public.

22 43. Premera's goal of seeking an RBC level of 500% to 600% does not constitute a  
23 basis for the Commissioner to disapprove the Conversion.

24 44. Premera's Board of Directors' business decision to obtain an improvement in its  
RBC level through the equity markets is reasonable and prudent.

25 45. Premera's desire to improve its RBC level through raising capital in the equity  
markets is not unfair or unreasonable to Premera's subscribers, nor is it contrary to  
the public interest. Premera's desire to obtain an improvement in its RBC level

1 through the equity markets is reasonable and prudent and thus is in the public  
2 interest.

3 46. Premera's desire to obtain an improvement in its RBC level through the equity  
4 markets is not hazardous or prejudicial to the insurance-buying public. To the  
contrary, it is to the benefit of the insurance-buying public.

5 47. Premera's desire to obtain an improvement in its RBC level through the equity  
6 markets does not constitute a basis for the Commissioner to disapprove the  
Conversion.

7 **The Tax Consequences of Conversion Do Not Constitute a Basis for Disapproval**

8 48. The question of whether the Conversion constitutes a tax-free reorganization under  
9 federal law does not constitute a basis for disapproval of the proposal.

10 49. The question of whether the Conversion could result in an eventual loss of a  
11 federal tax deduction does not constitute a basis for disapproval of the proposal.

12 50. The classification of the Foundations either as IRC 501(c)(4) organizations or, in  
13 the alternative, as IRC 501(c)(3) organizations, does not constitute a basis for  
disapproval of the proposal.

14 **Premera's Current and Future Executive Compensation Practices Are Reasonable**

15 51. Premera's pre-conversion executive compensation programs are reasonable.

16 52. Premera's pre-conversion executive compensation programs are not unfair or  
17 unreasonable to Premera's subscribers, nor are they not in the public interest.

18 53. Premera's pre-conversion executive compensation programs are not hazardous or  
19 prejudicial to the insurance-buying public.

20 54. Premera's pre-conversion executive compensation programs do not constitute a  
basis for the Commissioner to disapprove the Conversion.

21 55. Premera's post-conversion executive compensation programs do not constitute a  
22 basis for the Commissioner to disapprove the Conversion.

23 56. Premera's post-conversion equity incentive plan for its executives and directors is  
reasonable and was approved by Premera's Compensation Committee.

24 57. Premera's post-conversion equity incentive plan for its executives and directors is  
25 not unfair or unreasonable to Premera's subscribers, nor is it contrary to the public  
interest.

1 58. Premera's post-conversion equity incentive plan for its executives and directors is  
2 not hazardous or prejudicial to the insurance-buying public.

3 59. Premera's post-conversion equity incentive plan for its executives and directors  
4 does not constitute a basis for the Commissioner to disapprove the Conversion.

5 **Allocation Matters Are Not a Proper Subject of This Proceeding**

6 60. The United States Supreme Court is vested with exclusive jurisdiction to resolve  
7 disputes between states. U.S. Const. Art. III, § 2; 28 U.S.C. 1251(a); *Texas v. New*  
8 *Mexico*, 482 U.S. 124, 128, 107 S.Ct. 2279 (1987) ("By ratifying the Constitution,  
9 the States gave this Court complete judicial power to adjudicate disputes among  
10 them ...").

11 61. Absent an agreement between the states, the allocation of initial New PREMERA  
12 stock between the Washington and Alaska Foundations cannot be finally  
13 determined in either this proceeding (where the ADI is not a party) or the Alaska  
14 administrative proceeding to follow (where the OIC is not a party).

15 62. Therefore, the question of allocation is one solely for negotiation or, if that fails,  
16 for litigation between the states in another forum.

17 63. Exhibit G-22 to the Amended Form A, the Unallocated Shares Escrow Agent  
18 Agreement, is a reasonable mechanism for managing any shares that remain in  
19 dispute between the states until said dispute is resolved.

20 64. The absence of an allocation agreement between the states does not afford any  
21 basis to deny or condition approval of the Amended Form A Statement.

22 **Charitable Trust or Fair Market Value or Fair Value Issues**  
23 **Are Not Proper Subjects of this Proceeding**

24 65. Questions of charitable trust or the transfer of fair market value or fair value are  
25 not part of the HCA and do not lie within the authority of the Commissioner to  
resolve. *See Inland Foundry Co. v. Spokane County Air Pollution Control Auth.*,  
98 Wn. App. 121, 124, 989 P.2d 102, 103 (1999) ("An administrative review  
board has only the jurisdiction conferred by its authorizing statute.").

66. The presence of charitable assets cannot be presumed; rather, there must be a clear  
showing both that the corporation's activities are charitable and that the donor of  
the assets intended that they be used only for charitable purposes. *See, e.g.,*  
*Baarslag v. Hawkins*, 12 Wn. App. 756, 763-64, 531 P.2d 1283, 1287 (1975); *In re*  
*Multiple Sclerosis Serv. Org.*, 496 N.E.2d 861, 864 n.5, 168 N.Y.2d 32 (N.Y.  
1986); *City of Fort Payne v. Fort Payne Athletic Ass'n*, 567 So.2d 1260, 1264  
(Ala. 1990).

1 67. Even if the question of charitable restrictions upon Premera's assets were properly  
2 before the Commissioner, there would be no basis in this record to conclude that  
Premera's assets are so encumbered.

3 68. Speculation or criticism that is based on the premise that Premera is a charity  
4 and/or that fair market value or fair value has not been transferred to the  
5 foundations cannot serve as a basis to disapprove the Amended Form A Statement  
or to impose conditions upon approval.

6 **ORDER**

7 Based on the foregoing Findings of Fact and Conclusions of Law, Premera's  
8 Amended Form A Statement is APPROVED.

9 This \_\_\_\_ day of \_\_\_\_\_, 2004.

10  
11  
12 Mike Kreidler  
Insurance Commissioner

13  
14  
15 Presented May 28, 2004 by:

16 PRESTON GATES & ELLIS LLP

17  
18 By 

Thomas E. Kelly, Jr., WSBA # 05690

Robert B. Mitchell, WSBA # 10874

Ramona M. Emerson, WSBA # 20956

Laura K. Clinton, WSBA # 29846

Attorneys for Petitioner

PREMERA and Premera Blue Cross